No. 77-1811

In the Supreme Court of the United States

OCTOBER TERM, 1978

ALLIED FIDELITY CORPORATION, F.K.A.,
WILLIAM E. ROE, ALLIED AGENTS, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

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Petitioner seeks review of the decision below that its subsidiary, Allied Fidelity Insurance Corp., does not, qualify to be taxed as an insurance company under Sections 831 and 832 of the Internal Revenue Code of 1954 (26 U.S.C.) during 1971 and 1972.

The pertinent facts are as follows: During 1971 and 1972, Allied's principal business activity consisted of writing criminal bail bond contracts (Pet. App. A, p. A-2; Pet. App. B, p. B-6).[1] Allied sought to compute its taxable income for the years in question under the

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[1]Allied's original articles of incorporation also authorized it to enter into other types of surety and guaranty contracts (Pet. App. A, p. B-2). Although it began writing other forms of surety contracts in 1970, its bail bond contracts continued to account for more than 90 percent of its business in 1971 and nearly two-thirds of its business in 1972. During the latter year, Allied amended its articles of incorporation to permit it to engage in insuring a variety of casualty and other risks (Pet. App. A, p. A-2; Pet. App. B, pp. B-4, B-6).

special provisions of Sections 831 and 832 of the Code relating to insurance companies (other than life and certain mutual companies) (Pet. App. B, p. B-5). On audit, the Commissioner of Internal Revenue determined that Allied did not qualify as an insurance company, and recomputed its income under the Code provisions applicable to corporations generally (Pet. App. B, p. B-6). The Tax Court upheld the Commissioner's determination that Allied's bail bond contracts were not insurance contracts in the generally accepted sense of the term, so that it did not qualify for taxation as an insurance company (Pet. App. B, pp. B-7 to B-10).[2] The court of appeals affirmed. It ruled that the actual character of Allied's business was determinative of its status for federal income tax purposes, and rejected petitioner's contentions that bail bond contracts are insurance contracts designed simply to indemnify the government against economic loss on the failure of an accused to appear for trial (Pet. App. A, pp. A-3 to A-8).

1. Petitioner acknowledges (Pet. 6) that the question whether bail bonds are insurance contracts for federal income tax purposes is one of first impression. It nevertheless urges review by this Court on the ground (Pet. 8-11) that Allied's subjection to regulation by the insurance departments of the states in which it did business should have been determinative of its status for

[2]The Tax Court also rejected petitioner's alternative contention that it would be entitled to compute its income and deductions in essentially the same manner as permitted under Section 832 even if it did not qualify as an insurance company (Pet. App. B, pp. B-10 to B-14). Petitioner did not raise this argument in the court of appeals and does not renew it here.

federal income tax purposes. But this contention was properly rejected by both the Tax Court (Pet. App. B, p. B-7) and the court of appeals (Pet. App. A, p. A-4). The pertinent provisions of Section 1.801-1(b)(2) of the Treasury Regulations on Income Tax (26 C.F.R.) are squarely to the contrary. They provide that while the "name, charter powers, and subjection to State insurance laws are significant in determining the business which a corporation is authorized and intends to carry on," it is "the character of the business actually done in the taxable year [that] determines whether it is taxable as an insurance company under the Code." See also Treasury Regulations, Section 1.801-3(a). Petitioner has never challenged the validity of these Regulations, the language of which is derived, almost verbatim, from this Court's decision in *Bowers* v. *Lawyers Mortgage Co.*, 285 U.S. 182, 188. Indeed, petitioner agreed in the Tax Court that Allied would qualify as an insurance company for tax purposes only if its bail bond contracts could be categorized as insurance contracts (Pet. App. B, p. B-7).

Accordingly, both the Tax Court and the court of appeals viewed the question as turning on whether Allied's bail bond contracts were contracts of insurance under the generally accepted meaning of that term.[3] On

[3]Petitioner's contention (Pet. 8-10) that the decision below conflicts with *Bowers* v. *Lawyers Mortgage Co., supra,* 285 U.S. 182 and its companion case, *United States* v. *Home Title Insurance Co.*, 285 U.S. 191, is without merit. In *Lawyers Mortgage Co.*, the Court held that a company whose business did not consist of issuing insurance contracts was not entitled to be taxed as an insurance company despite the fact that it was chartered and regulated as an insurance company under state law. As we have pointed out above, that decision provides the basis for the test set forth in the Treasury Regulations and applied by the courts below. In *Home Title*, the taxpayer prevailed on its claim to be taxed as an insurance company because more than 75 percent of its income was from the issuance of insurance contracts (see 285 U.S. at 195). *United States* v. *Cambridge Loan and Building Co.*, 278 U.S. 55, upon which petitioner also relies

that question, both courts correctly held that bail bond contracts do not fall within the commonly understood meaning of the term as encompassing "risk-shifting and risk distributing" devices (*Helvering* v. *LeGierse*, 312 U.S. 531, 539), under which an insurer assumes the risk of another's economic loss. See 1 *Couch on Insurance* §1:2 (2d ed. 1959). No doubt, many forms of surety contracts do serve this purpose. Bail bond contracts, however, do

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(Pet. 8-10), dealt with the wholly different question whether a state-chartered building and loan association qualified as a domestic building and loan association for federal tax purposes. The Court in *Lawyers Mortgage Co.* regarded *Cambridge Loan and Building Co.* as distinguishable (see 285 U.S. at 190).

Petitioner's reliance (Pet. 11) on *United States* v. *Consumer Life Insurance Co.*, 430 U.S. 725, and *Commissioner* v. *Standard Life & Accident Insurance Co.*, 433 U.S. 148, is similary misplaced. The former case involved the question whether an insurance company qualified as a life insurance company under the 50 percent reserve ratio test of Section 801(a). The decision turned in large part on the Court's recognition that the draftsmen of the statutes in question had been "careful to underscore the continuing primacy of state regulation, with *specific reference to the question of reserves*." 430 U.S. at 749-750 (emphasis added; footnote omitted).

Standard Life involved a narrow question with respect to the proper accounting treatment of a life insurance company's deferred and uncollected premiums. The Court concluded that Congress had provided in Section 818(a) of the Code that the accounting procedures mandated for such premiums under state law would be controlling for tax purposes. Neither decision, however, can be read to accord controlling status to state practices for all accounting questions under Subchapter L, or with respect to the threshold question whether a company qualifies for taxation as an insurance company. See *Western Cas. & Sur. Co.* v. *Commissioner*, 571 F. 2d 514 (C.A. 10).

not. As the court of appeals concluded (Pet. App. A, p. A-5), the historical obligation of the bondsman has been "to produce the accused or suffer forfeiture of the monetary security as a penalty."[4]

Moreover, the forfeiture of a bail bond by the bondsman is intended as a penalty and not as compensation for economic loss. As the court of appeals observed (Pet. App. A, p. A-5), "[t]he interest of the government is impecuniary and non-financial." Nor can it be said that the company is insuring the accused (who remains liable to the bondsman for any forfeiture) against the possibility that he might default and be subjected to such a penalty. Thus, the bail bond contract is not insurance in the ordinary sense of that term, even though the states may so classify such contracts under special statutory provisions designed to subject bail bondsmen to the regulation of their insurance departments.

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[4]As this Court noted in *Taylor* v. *Taintor*, 16 Wall. 366, 371: "[t]he principal is regarded as delivered to the custody of his sureties. Their dominion is a continuance of the original imprisonment." Despite the Court's subsequent statement in *Leary* v. *United States*, 224 U.S. 567, 575-576, that the "distinction between bail and suretyship is pretty nearly forgotten," the bondsman's broad powers and constructive custody over the person of the accused under *Taylor* v. *Taintor* continue to be recognized. See *Ouzts* v. *Maryland National Insurance Co.*, 505 F. 2d 547, 551 (C.A. 9); *United States* v. *Holmes*, 452 F. 2d 249 (C.A. 7); *United States* v. *Croft*, 450 F. 2d 1094, 1099 (C.A. 6); *United States* v. *Goodwin*, 440 F. 2d 1152, 1156 (C.A. 3). See also *Carlson* v. *Landon*, 342 U.S. 524, 547; *Continental Casualty Co.* v. *United States*, 314 U.S. 527, upon which petitioner also relies (Pet. 13), is not to the contrary. There, the Court held that the only party that can willfully default on a bail bond is the principal in the recognizance (*i.e.*, the accused) and not the bondsman.

2. Finally, petitioner's assertions (Pet. 5-7, 11-12) as to the administrative importance of this case are based almost exclusively on the speculative possibility that the Commissioner might seek to deny insurance company status to companies engaged primarily in issuing other types of surety and guaranty contracts or to deny insurance accounting treatment with respect to premiums, losses, etc., on such surety business even in the case of qualifying insurance companies. Neither of these questions, however, is presented in this case.[5] With respect to the question that is in fact presented involving bail bond contracts, the absence of administrative importance is demonstrated by the fact that, even though the Commissioner ruled ten years ago that a corporation engaged primarily in the business of writing bail bonds is not an insurance company for purposes of Sections 831 and 832 of the Code (Rev. Rul. 68-101, 1968-1 Cum. Bull. 319), this case is the first and, thus far, the only litigated case involving a challenge to that position.[6]

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[5]Petitioner states (Pet. 6, 11) that it has been advised that the Internal Revenue Service is now taking the position, based on the decision below, that other types of surety contracts do not qualify as insurance for federal tax purposes. But the decision below turns on the special nature of bail bond contracts, and not on the nature of suretyship contracts generally. Moreover, the published position of the Commissioner recognizes that companies engaged in such surety and fidelity business may qualify for taxation as insurance companies. See. Rev. Rul. 61-167, 1961-2 Cum. Bull. 130.

[6]As petitioner indicates (Pet. 6), the National Association of Independent Insurers, representing more than 600 property liability insurance companies, appeared as *amicus curiae* in the court below. But the *amicus* did not indicate that the federal tax status of any of its members would be directly affected by the decision in this case.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

AUGUST 1978.

DOJ-1978-08